No. SC92314

IN THE SUPREME COURT OF MISSOURI

AMERICAN AIRLINES, INC.

Appellant

v.

DIRECTOR OF REVENUE,

Respondent

On Petition for Review from the Administrative Hearing Commission

Hon. Sreenivasa Rao Dandamudi, Commissioner

APPELLANT AMERICAN AIRLINES, INC.'S REPLY BRIEF

THOMPSON COBURN LLP
James W. Erwin, #25621
Janette M. Lohman, #31755
One US Bank Plaza
St. Louis, MO 63101-1693
Telephone: (314) 552-6000
Facsimile: (314) 552-7000
E-mail: jerwin@thompsoncoburn.com
jlohman@thompsoncoburn.com

Attorneys for Appellant
American Airlines, Inc.

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I. Introduction

The transactions by which American Airlines, Inc. provided jet fuel to Chautauqua Airlines and Trans-States Airlines (the "AmericanConnection carriers") at Lambert St. Louis International Airport were not "sales at retail" because American did not transfer either title or ownership of the fuel to the AmericanConnection carriers. American retained dominion and control over the use of the fuel through the Air Services Agreements and — most importantly for this case — through an oral side agreement between the parties.

American decided how, where and when the fuel would be used. The initial payment and month-end reimbursements of the monies involved in the transaction had no effect on title or ownership of the fuel. The fuel was always in American's possession and control because American controlled the aircraft and its pilots through the "wet lease" arrangements in the written and oral agreements. American directed how the flights were to use the fuel by contractually specifying the aircraft and equipment in which the fuel could be placed, the destinations of the flights, and the schedule the AmericanConnection carriers were to fly. The fuel could be only used for AmericanConnection flights flown on routes scheduled by American, in aircraft designated by American and bearing the AmericanConnection banner, carrying American passengers with American tickets sold by American.

These transactions were not, as the Director claims, "conditional sales" because American did not retain an interest in the fuel to secure payment by the

AmericanConnection carriers. American never relinquished dominion and control over the fuel, and thus retained title to and ownership of the fuel. The AmericanConnection carriers could use the fuel only on American flights, only in aircraft leased and equipped as directed by American, only to destinations as directed by American, and only on schedules determined by American by pilots also leased by American carrying American passengers. The AmericanConnection carriers had no right to use the fuel as they wished — which is the hallmark of title and ownership.

The Director's point that the AmericanConnection carriers *could* have purchased the fuel themselves is irrelevant. The Court is concerned with what actually happened, not with what could have happened.

The Director quoted various snippets from the Air Services Agreements, but ignored the stipulated facts — in particular, Stipulation No. 23 — which, in conjunction with the written Agreements, demonstrates that in these transactions, American retained complete control over the use of the fuel.[1] The Director claims, for example, that the pilots

[1] The Director suggests that the Court owes deference to the Commission's factual findings. Resp. Br. at 11. The pertinent evidence is a stipulation of facts entered into by the parties. *See* Appendix to Appellant's Opening Brief at A20-A29. The only testimony related to the circumstances leading to American's decision to seek a refund, which was not contested. Therefore, the only question is whether the Commission drew the proper legal conclusions from the stipulated facts. The Court owes no deference to the

employed by the AmericanConnection carriers exercised dominion and control over the fuel apart from any direction by American. The Director's contention ignores the character of the Air Services Agreements as "wet leases" in which American leased not only the aircraft but also the personnel to fly them. Also, the Director ignores the contractual provisions whereby American directed where, when and how the leased pilots would fly the planes serving American routes. Thus, American effectively controlled both the aircraft and the pilots in the contested transactions.

In short, there was no "sale at retail" as defined in the statute because neither title nor ownership of the jet fuel was transferred to the AmericanConnection carriers. In the absence of a taxable event, American is entitled to a refund of the sales taxes it collected and remitted to the Director.

II. American Retained The Right To Control The Use And Disposition Of The Fuel Under The Written And Oral Agreements

The dispositive issue is whether American or the AmericanConnection carriers have the right to control the use or disposition of the jet fuel. The party with that right has title or ownership of the fuel.

The Director equates the transactions here to a "conditional sale," citing *Municipal Acceptance Corp. v. Canole*, 342 Mo. 1170, 119 S.W.2d 820 (banc 1938), because the sales were supposedly made "on conditions." "Conditional sale" as used in the sales tax

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Commission's findings. *White v. Director of Revenue*, 321 S.W.3d 298, 308 (Mo. banc 2010).

statute, § 144.010.1(10), is a term of art in the financing business. In a conditional sale, the seller retains title to the property to secure repayment of the purchase price, usually on an installment basis. *See, e.g., Canole*, 342 Mo. at 1176, 119 S.W.2d at 822. Nothing in the facts here supports the notion that these transactions were "conditional sales."

The Director relies on *Kansas City Power and Light Co. v. Director of Revenue*, 83 S.W.3d 548 (Mo. banc 2002) for the proposition that transfer of the right to "use, store or consume" tangible personal property is a "sale at retail." But that case has no legal or factual bearing on this one.

First, the language quoted by the Director — the right to "use, store or consume" tangible personal property — is found in the use tax statute, § 144.605.7 RSMo. Use taxes are not at issue here. Second, in *Kansas City Power and Light,* the party to whom the electricity was sold decided whether to turn the lights on or use the air conditioner consuming the electricity. Here, however, the AmericanConnection carriers had no such discretion. They were required to use the jet fuel in the aircraft American designated at times and on routes as directed by American.[2]

[2] The Director frequently refers to the AmericanConnection carriers as "independent airlines," as if corporate ownership makes a difference. It does not. For example, there is no question that Olin Corporation was independent of the United States government in *Olin Corp. v. Director of Revenue*, 945 S.W.2d 442 (Mo. banc 1997). The dispositive issue there was, as it is here, whether the party receiving the property acquired title or ownership of it.

The Director also argues that the AmericanConnection carriers had the contractual and practical right to control the disposition of the fuel after it was put in the aircraft because its employees were the pilots who flew them. This ignores the nature of the agreements. They were wet leases: agreements by which American not only leased the aircraft that flew the American routes, but also the services of crew, *i.e.*, the pilots who flew the aircraft. *See* 14 C.F.R. § 212.2 (Wet lease defined as "a lease between direct air carriers by which the lessor provides all or part of the capacity of the aircraft, and its crew"), and 14 C.F.R. § 217.2, § 257.3 (wet lease is "lease by which the lessor provides an aircraft or crew dedicated to a particular route(s)").

The Director points out that the AmericanConnection carriers were not obligated to buy fuel from American by the Air Services Agreements, and that American was not obligated to sell fuel to them. Resp. Br. at 21-22. While true, it is irrelevant. The question is not what the parties could have done. Obviously, if the facts were different, the result might well be different, too. Rather, the issue is whether, in the transactions that actually occurred, American transferred title or ownership of the jet fuel to the AmericanConnection carriers.

Moreover, the Director's Brief completely ignores the parties' side agreement regarding fuel, where they agreed that "Chautauqua and Trans-States were not permitted to use and did not use any of the aviation jet fuel received from suppliers of American Airlines on any flights operated for their own common carrier business or for other carriers other than those operated under the AmericanConnection banner." Stipulation

No. 23; App. at A26. This agreement, as noted in the Stipulation, superseded the language of the Air Services Agreement.

Finally, the "Airport Support Services" regarding fueling mentioned in the contracts relate to the actual pumping of the fuel into the aircraft by the fuel trucks. Ex. 3, p. 3-35 ; Ex. 4, p. 4-16. This service was performed by an unrelated third party for both American and the AmericanConnection carriers. Stip. Nos. 20, 21; App. at A26. That the jet fuel was delivered by Sunoco and Conoco to a tank farm operated by a third party and delivered to the aircraft by the third party does not mean that American failed to acquire title and ownership of the fuel when it was delivered to the airport. It simply meant that the airlines at Lambert paid another company to provide that service. The company fueling the aircraft did not acquire title or ownership to the fuel — the fuel was always owned by American, regardless of who pumped it into the aircraft's fuel tanks or the identity of the operator of the aircraft.

III. American Exercised The Right To Control How, Where, And When The Jet Fuel Was To Be Used, And Thus There Was No Transfer Of Title Or Ownership To The AmericanConnection Carriers

The Director attempts to distinguish *Olin Corp. v. Director of Revenue*, 945 S.W.2d 442 (Mo. banc 1997) by asserting that Olin was merely an "intermediary handling agent" for the United States government under their contract. Resp. Br. at 23. Olin operated a plant in which its employees manufactured small-caliber ammunition. *See id*. at 443. Olin did not simply receive the materials, and pass them on to the government. Rather, Olin's employees took the materials and made them into ammunition. As the

AmericanConnection carriers did here, Olin furnished the necessary equipment to carry out its contractual obligations. *See id*. at 443. And, as American did here, the government provided detailed specifications to Olin as to how, when, and where to carry out the latter's contractual obligations. *See id*. at 444.

The Director claims that the Air Services Agreements do not provide "detailed provisions" regarding how, when and where the fuel could be used, but the Director completely ignores the existence of the oral side agreement that provides precisely that: the fuel was to be used and was only used to fly American routes to destinations specified only by American and at times specified only by American. Stip. No. 23; App. at A27..

The Director also ignores the extensive control American exercised over the AmericanConnection carriers. This included not only the above restrictions on the use of the fuel, but also other provisions relating to the use of the fuel, such as designating the aircraft that could be used to fly the routes, the equipment each aircraft had to have, and issuing the American tickets for the flights. Ex. 3, p. 3-64(aircraft and equipment); Ex. 4, p. 4-44(aircraft and equipment); Stip. No. 11, A22 (ticketing).

The Director contends that these matters are irrelevant. But American's extensive control over all aspects of the AmericanConnection carriers' operations is just as relevant as the government's control over Olin's manufacturing processes.

The Director says that neither the written nor the oral agreements said anything about storage or maintenance of the fuel. There was no need to address these matters in the contract because neither party stored or "maintained" the fuel. All of the fuel at Lambert was stored on a third party's tank farm until it was pumped into the planes. Thus, these

so-called omissions were not omissions at all. The Director ultimately concedes, as she must, that American had the right to decide how much fuel to put into the aircraft. Resp. Br. at 26.[3] That the AmericanConnection pilots actually flew the planes burning the fuel does not change the analysis of title and ownership here, just as the fact that Olin employees ran the machines making the ammunition did not affect the title or ownership of the property in that case.

The Director asserts that American merely paid "pass through" costs of the fuel, and thus transferred title or ownership of the fuel when it was put in the aircraft. The Director also claims that American did not pay for the entire cost of the jet fuel. Neither proposition is correct.

The Director once again ignores the oral side agreement reached regarding the provision of fuel at Lambert Airport. If no title or ownership was transferred, then it makes no difference that the AmericanConnection carriers first paid money for the fuel, and then were reimbursed for it. The payment of consideration is just one of several elements necessary to establish a "sale at retail."

[3] The Director also refers to the responsibilities for flight dispatch. Resp. Br. at 21. Flight dispatch, including the amount of fuel to be loaded on to any particular flight, is governed by federal regulations that prescribe a minimum amount of fuel for any domestic or international flight, and the factors to be considered in determining the amount of fuel to load. *See, e.g.*, 14 C.F.R. §§ 121.641-.647.

The Director's claim that American did not pay the AmericanConnection carriers for the full cost of the fuel that it supplied to them is incorrect. Curiously, the Director's Brief is silent about Exhibits 7 and 8, which demonstrate that each month American reimbursed the AmericanConnection carriers for all but a small amount of their fuel costs — including the sales taxes that American previously imposed and collected. (Indeed, the parties *stipulated* to the latter fact. *See* Stip. No. 27; App. at A28.)

The assertion that American did not pay for the fuel covered by the block hour payments indicates that the Director misunderstood the contract. The block hour and other payments were, in effect, a cost-plus type contract, where American paid the AmericanConnection carriers for their costs incurred, including the assumed cost of the fuel, plus a profit component. American's payments thus covered both the assumed cost of the fuel in the block hour calculation and the excess over the assumed cost — including the sales taxes at issue here that were collected and remitted to the Director.

Even though there was a 30-day delay in American making the reimbursements, this time lag in payment did not cause title or ownership of the fuel to pass to the AmericanConnection carriers. As discussed in detail above and in American's Opening Brief, American retained control over the use of the fuel from the time American purchased it through the actual use of the fuel. The AmericanConnection carriers did not exercise unfettered control over the use of the jet fuel, which is the hallmark of title or ownership, because the aircraft and flight crews involved in this dispute were wet leased to American to fly their aircraft for exclusive use by American on its routes to specified airports carrying American passengers holding American tickets.

The Director further claims (for the first time) that the fuel was used only for "independent air service flights" and not for fuel used in "ground handling." Resp. Br. at 29. "Ground Handling" is a defined term in the contracts. It refers to such matters as cleaning the aircraft cabin, replenishing cabin supplies such as food and drink, loading and unloading luggage, parking and pushing back the aircraft, emptying the toilets, and the like. Ex. 3, pp. 3-25, 3-26; Ex. 4, pp. 4-6, 4-7.

The Director's notion that fuel supplied by American was somehow used by the AmericanConnection aircraft during the course of these activities is not supported by the record. All but the parking and pushback services are performed when the aircraft is at the gate. The block hour clock starts to run when the aircraft is pushed back from the gate and does not stop until the aircraft is parked at the gate at its destination. *See, e.g.*, Ex. 3, p. 3-22.

Finally, the Director's musings about what might have happened had American become insolvent during the relevant tax period is just speculation unsupported by the record. There is nothing in the record to suggest that title or ownership to the fuel would be affected by any such hypothetical event.

CONCLUSION

For these reasons, American Airlines requests that the Court reverse the decision of the Administrative Hearing Commission, order the Director to refund to American Airlines the amount of $5,179,361.62, plus interest, and grant such other relief as the Court deems proper under the circumstances.

Respectfully submitted,

THOMPSON COBURN LLP

By: /s/ James W. Erwin

James W. Erwin, #25621
Janette M. Lohman, #31755
One US Bank Plaza
St. Louis, MO 63101-1693
Telephone: (314) 552-6000
Facsimile: (314) 552-7000

E-mail: jerwin@thompsoncoburn.com
jlohman@thompsoncoburn.com

Attorneys for Appellant American Airlines, Inc.

CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that this brief contains the information required by Rule 55.03, complies with the limitations in Rule 84.06(b), and it contains 2,699 words, excluding the parts of the brief exempted; and has been prepared in proportionally spaced typeface using Microsoft Word 2010 in 13 point Times New Roman font.

/s/ James W. Erwin

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing was served through the electronic filing system this 21st day of August 2012 upon the following:

James Layton, Solicitor
Jeremiah J. Morgan, Deputy
Solicitor General
Missouri Attorney General's Office
Supreme Court Building
207 W. High St.
P.O. Box 899
Jefferson City, MO 65102

Roger Freudenberg, Senior Counsel
Missouri Department of Revenue,
301 West High Street, Room 670
P.O. Box 475
Jefferson City, MO 65105

/s/ James W. Erwin